

action and such participants would authorize beneficial owners owning through such participants to give or take such action.

The Depository Trust Company has advised the Company that The Depository Trust Company is a limited-purpose trust company organized under the Banking Law of the State of New York, a member of the Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code and a "clearing agency" registered under the Exchange Act. The Depository Trust Company was created to hold the securities of its participants and to facilitate the clearance and settlement of securities transactions among its participants in such securities through electronic book-entry changes in accounts of the participants, thereby eliminating the need for physical movement of securities certificates. The Depository Trust Company's participants include securities brokers and dealers, which may include the Initial Purchasers, banks, trust companies, clearing corporations and certain other organizations some of whom, or their representatives, own The Depository Trust Company. Access to The Depository Trust Company's book-entry system is also available to others, such as banks, brokers, dealers and trust companies, that clear through or maintain a custodial relationship with a participant, either directly or indirectly.

Although The Depository Trust Company has agreed to the foregoing procedures in order to facilitate transfers of interests in global securities among participants of The Depository Trust Company, it is under no obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time. None of the Company, the trustee or the initial purchasers will have any responsibility for the performance by The Depository Trust Company or its participants or indirect participants of their respective obligations under the rules and procedures governing their operations.

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#### PLAN OF DISTRIBUTION

Each participating broker-dealer that receives exchange notes for its own account pursuant to the exchange offer must acknowledge that it will deliver a prospectus meeting the requirements of the Securities Act in connection with any resale of exchange notes received pursuant to the exchange offer. This prospectus, as it may be amended or supplemented from time to time, may be used by a participating broker-dealer in connection with resales of exchange notes received in exchange for old notes where such old notes were acquired as a result of market-making activities or other trading activities. Telecomunicaciones de Puerto Rico has agreed that, starting on the expiration date and ending on the close of business one year after the expiration date, it will make this prospectus, as amended or supplemented, available to any broker-dealer for use in connection with any resale of those exchange notes. In addition, until January 25, 2000, all dealers effecting transactions in the exchange notes may be required to deliver a prospectus.

We will not receive any proceeds from any sales of the exchange notes by participating broker-dealers. Exchange notes received by participating broker-dealers for their own account pursuant to the exchange offer may be sold from time to time in one or more transactions in the over-the-counter market, in negotiated transactions, through the writing of options on the exchange notes or a combination of those methods of resale, at market prices prevailing at the time of resale, at prices related to such prevailing market prices or negotiated prices. Any resale of that kind may be made directly to purchasers or to or through brokers or dealers who may receive compensation in the form of commissions or concessions from any of those participating broker-dealers and/or the purchasers of any of those exchange notes. Any participating broker-dealer that resells the exchange notes that were received by it for its own account pursuant to the exchange offer and any broker or dealer that participates in a

distribution of these exchange notes may be deemed to be an "underwriter" within the meaning of the Securities Act and any profit on any resale of exchange notes and any commissions or concessions received by those persons may be deemed to be underwriting compensation under the Securities Act. The letter of transmittal states that by acknowledging that it will deliver and by delivering a prospectus meeting the requirements of the Securities Act, a participating broker-dealer will not be deemed to admit that it is an "underwriter" within the meaning of the Securities Act.

For a period of one year after the expiration date, Telecomunicaciones de Puerto Rico will promptly send additional copies of this prospectus and any amendment or supplement to this prospectus to any broker-dealer that requests those documents in the Letter of Transmittal. Telecomunicaciones de Puerto Rico has agreed to pay all the expenses incident to this exchange offer, including the expenses of one counsel for the holders of the old notes, and will indemnify the holders of the old notes, including broker-dealers, against specific liabilities, including liabilities under the Securities Act.

#### BROKER DEALER OBLIGATIONS

Each broker-dealer that receives exchange notes for its account pursuant to this exchange offer must acknowledge that it will deliver a prospectus in connection with any resale of those exchange notes. The letter of transmittal states that by so acknowledging and by delivering a prospectus, a broker-dealer will not be deemed to admit that it is an underwriter within the meaning of the Securities Act. This prospectus, as it may be amended or supplemented from time to time, may be used by a broker-dealer in connection with resales of exchange notes received in exchange for old notes where those old notes were acquired by that broker-dealer as a result of market-making activities or other trading activities. Telecomunicaciones de Puerto Rico has agreed that, starting on the expiration date and ending on the close of business one year after the expiration date, it will make this prospectus available to any broker-dealer for use in connection with any resale. See "Plan of Distribution."

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#### TAX CONSIDERATIONS

##### GENERAL

The following summary describes the material United States federal income and Puerto Rico tax consequences of the acquisition, ownership, and disposition of exchange notes by (a) in the case of United States federal income tax consequences, U.S. holders, and (b) in the case of Puerto Rico tax consequences, holders that are not Puerto Rico holders. The summary is based on the advice of Curtis, Mallet-Prevost, Colt & Mosle LLP, New York, with respect to United States federal income taxes and the advice of O'Neill & Borges, Puerto Rico, with respect to Puerto Rico taxes. The advice provided by Curtis, Mallet-Prevost, Colt & Mosle LLP is based on the United States Internal Revenue Code of 1986, as amended, Treasury Regulations (including proposed Regulations and temporary Regulations) promulgated thereunder, rulings, official pronouncements and judicial decisions, all as in effect on the date of this prospectus, and the advice of O'Neill & Borges is based on the Puerto Rico Internal Revenue Code of 1994, as amended, the regulations issued under the Puerto Rico Code and its predecessor statute, the Puerto Rico Income Tax Act of 1954, administrative practice and judicial decisions, all as in effect and applicable on the date of this prospectus; all of which are subject to change, possibly with retroactive effect, and to different interpretations. This summary does not purport to address all of the tax consequences that may be applicable to holders of exchange notes.

For purposes of this summary, a U.S. holder is any holder of exchange notes who or that is, for United States federal income tax purposes:

- in the case of an individual, a resident of the United States, or a citizen of the United States who is not a bona fide resident of Puerto Rico during the entire taxable year within the meaning of Section 933 of the Code,
- a corporation, partnership, or other entity created or organized in or under the laws of the United States, or any political subdivision thereof,
- an estate the income of which is includible in gross income for United States federal income tax purposes regardless of source or
- a trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more United States persons have the authority to control all substantial decisions of the trust.

For purposes of this summary, a Puerto Rico holder is any holder of exchange notes who or that is, for Puerto Rico tax purposes:

- an individual, trust or estate resident of Puerto Rico,
- a Puerto Rico corporation or partnership,
- an individual, trust or estate engaged in a trade or business in Puerto Rico, or
- a non-Puerto Rico corporation or partnership engaged in a trade or business in Puerto Rico.

The description of the United States federal income tax and Puerto Rico tax laws set forth below is based on the laws in force as of the date of this prospectus and is subject to any changes in applicable United States or Puerto Rico tax laws.

Each prospective holder should consult its tax advisors with respect to the tax treatment applicable to such holder.

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## UNITED STATES FEDERAL INCOME TAX CONSIDERATIONS

### GENERAL

The following is a summary of the material United States federal income tax consequences of the purchase, ownership, and disposition of exchange notes by U.S. holders that hold exchange notes as capital assets as defined in Section 1221 of the Code. This summary is not addressed to certain types of holders subject to special treatment under United States federal income tax law, such as individual retirement and other tax-deferred accounts, dealers in securities or currencies, insurance companies, tax-exempt organizations, persons holding exchange notes as part of a straddle, hedging, conversion or other integrated transaction, or persons whose functional currency is other than the U.S. Dollar.

The discussion below does not address United States federal estate and gift tax considerations or the effect of any United States state or local tax law. Persons considering the purchase of exchange notes should consult their own tax advisors concerning the application of the United States federal income tax law to their particular situations as well as any tax consequences arising under the law of any state, local or foreign tax jurisdiction.

### REGISTRATION OF NOTES

The exchange of old notes for exchange notes pursuant to the exchange offer will not be treated as an exchange or other taxable event for U.S. federal income tax purposes. Accordingly, there will be no U.S. federal income tax consequences to holders of old notes who exchange old notes for exchange notes pursuant to the exchange offer, and that holder will have the same adjusted tax basis and holding period in the exchange notes as that holder had in the old notes immediately before the exchange.

#### TAXATION OF INTEREST

The gross amount of interest in respect of the exchange notes generally will be included in a U.S. holder's gross income as ordinary income at the time it accrues or is paid, in accordance with the U.S. holder's usual method of tax accounting for United States federal income tax purposes.

Interest on the exchange notes generally will be treated as foreign source income for United States federal income tax purposes.

#### MARKET DISCOUNT

If a U.S. holder purchases an exchange note after its issue for an amount that is less than its principal amount, then the amount of the difference will be treated as "market discount" for United States federal income tax purposes, unless the difference is less than a specified de minimis amount.

Under the market discount rules, a U.S. holder will be required to treat any principal payment on an exchange note, or any gain on its sale, exchange, retirement or other disposition, as ordinary income to the extent of the market discount which has not previously been included in income. If the exchange note is disposed of in a non-taxable transaction (other than a nonrecognition transaction described in section 1276(c) of the Code), accrued market discount will be included as ordinary income to the U.S. holder as if the holder had sold the exchange note at its fair market value. In addition, a U.S. holder may be required to defer, until the maturity of an exchange note or its earlier disposition (including a non-taxable transaction other than a transaction described in section 1276(c) of the Code), the deduction of all or a portion of the interest expense in respect of any indebtedness incurred or continued to purchase or carry the exchange note.

Any market discount will be considered to accrue ratably during the period from the date of acquisition to the maturity date of an exchange note, unless the holder elects to accrue such discount on a constant yield basis. A U.S. holder of an exchange note may elect to include market discount in income currently, as it accrues (on either a ratable or a constant yield basis), in which case the rules described above regarding the treatment as ordinary income of gain upon the disposition of an exchange note and upon the receipt of certain cash payments, and regarding the deferral of interest deductions, will not apply. This election to include

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market discount in income currently, once made, applies to all market discount obligations acquired on or after the first taxable year to which the election applies, and may not be revoked without the consent of the Internal Revenue Service.

In its fiscal year 2000 budget proposal, the Clinton Administration recently proposed altering the taxation of market discount. Under the proposal, subject to certain limitations, accrual basis U.S. holders would be required to include market discount in income as it accrues. The proposal would affect U.S. holders of debt instruments, such as the exchange notes, acquired on or after the date of enactment.

#### AMORTIZABLE BOND PREMIUM

If a U.S. holder purchases an exchange note for an amount that is greater than the amount payable at maturity, the excess will be considered an "amortizable bond premium." Such a holder may elect to amortize the bond premium to offset the interest from the exchange note he would otherwise be required to include in income. In any tax year, a holder can only use as much of the bond premium as the constant yield method would allocate to that year. The U.S. holder's basis in an exchange note will be reduced by the amount of bond premium offset against interest.

#### TAXATION OF DISPOSITIONS

A U.S. holder generally will recognize gain or loss for United States federal income tax purposes upon the sale, exchange, retirement or other disposition of the exchange note in an amount equal to the difference between the amount realized and the U.S. holder's tax basis in the exchange note. A U.S. holder's tax basis in an exchange note will generally be the cost of the exchange note, increased by any market discount previously included in income by the U.S. holder, and reduced by any amortized bond premium. For these purposes, the amount realized does not include any amount attributable to accrued interest on the exchange note, which will be taxable as interest income.

Except as described above with respect to market discount and accrued interest, the gain or loss will be capital gain or loss. If, at the time of sale, exchange, or retirement, the exchange note has been held for more than 12 months, the gain or loss will be long-term capital gain or loss. If the exchange note has been held for less than 12 months, the gain or loss will be short-term capital gain or loss. Under current law, net long-term capital gains of individuals are typically taxed at lower rates than items of ordinary income. The deductibility of capital losses is subject to limitations. Any gain or loss recognized by a U.S. holder generally will be treated as from sources within the United States for United States federal income tax purposes.

#### UNITED STATES TAXATION OF NON-U.S. HOLDERS

An individual holder of exchange notes who is a bona fide resident of Puerto Rico during the entire taxable year within the meaning of Section 933 of the Code will not be subject to United States federal income tax on payments of interest on the exchange notes provided that (a) for the 3 year period ending with the close of Telecomunicaciones de Puerto Rico taxable year immediately preceding the payment of interest, or the part of that period as may be applicable, less than 80% of the Telecomunicaciones de Puerto Rico gross income is derived from sources outside Puerto Rico and attributable to the active conduct of a trade or business outside Puerto Rico, this determination to be made under Section 861(c)(1)(B) of the Code and provided that interest on the exchange notes is not treated as paid by a trade or business outside Puerto Rico by Telecomunicaciones de Puerto Rico, this determination to be made under Section 884(f)(1)(A) of the Code, and (b) the payments of interest on the exchange notes are not effectively connected with the conduct by the holder of a trade or business in the United States. Pursuant to Notice 89-40 issued by the United States Internal Revenue Service on March 27, 1989, gain on the sale of the exchange notes by a Section 933 Holder who is not a United States resident for purposes of Section 865(g)(1) of the Code will constitute Puerto Rico source income and, therefore, will not be subject to United States federal income tax provided the exchange notes do not constitute inventory in the hands of the holder, and provided the gain is not effectively connected with the conduct by the holder of a trade or business in the United States.

Holders of exchange notes that are not U.S. holders and not Section 933

Holders will not be subject to United States federal income tax on payments of interest with respect to the exchange notes unless such interest is effectively connected with the conduct by the non-U.S. holders of a trade or business in the United States. A non-U.S. holder generally will not be subject to United States federal income tax on any gain realized on the sale or other disposition of exchange notes, unless (a) such gain is effectively connected with the conduct by the non-U.S. holder of a trade or business in the United States, or (b) in the case of gain realized by an individual non-U.S. holder, the non-U.S. holder is present in the United States for 183 days or more during the year of the sale or disposition and certain other conditions are met.

#### BACKUP WITHHOLDING AND INFORMATION REPORTING

United States "backup" withholding may apply to certain payments of principal and interest on the exchange notes and to certain payments of proceeds from the sale or retirement of the exchange notes. Generally such payments made by mail or wire transfer to an address in the United States or made by a paying agent, broker or other intermediary in the United States will be subject to a backup withholding tax equal to 31% of such payments if the U.S. holder fails to furnish his taxpayer identification number (social security number or employer identification number), to certify that it is not subject to backup withholding, or to otherwise comply with the applicable requirements of the backup withholding rules.

Certain U.S. holders (including, among others, all corporations) are not subject to backup withholding. Interest paid with respect to exchange notes, and payment of the proceeds from a sale of exchange notes to or through the United States office of a broker or other intermediary, received by a non-U.S. holder will be subject to backup withholding unless the payer has received the appropriate certification from the non-U.S. holder or the non-U.S. holder otherwise establishes an exemption therefrom. Payments made outside the United States or to a non-U.S. holder by a non-U.S. broker or other intermediary generally will not be subject to these United States certification requirements. In addition, information reporting requirements may apply to certain payments of principal and interest in respect of the exchange notes and to certain proceeds from the sale or other disposition of the exchange notes.

Any amounts withheld under the backup withholding rules from a payment to a U.S. holder or non-U.S. holder with respect to the exchange notes will be allowed as a refund or credit against the U.S. holder or non-U.S. holder's United States federal income tax liability; provided, however, the holder timely furnishes the required information to the United States Internal Revenue Service.

The Treasury Department has promulgated final regulations, which are generally effective for payments made after December 31, 2000, subject to certain transition rules, regarding the backup withholding rules discussed above. In general, the final regulations do not significantly alter the substantive withholding and information reporting requirements, but unify current certification procedures and forms and clarify reliance standards. Under the final regulations, special rules apply which permit the shifting of primary responsibility for withholding to certain financial intermediaries acting on behalf of beneficial owners.

#### PUERTO RICO TAX CONSIDERATIONS

##### GENERAL

This summary of certain Puerto Rico tax considerations deals only with holders of exchange notes who are not Puerto Rico holders.

##### PAYMENTS OF INTEREST

Interest on exchange notes received by a non-Puerto Rico holder who is a

citizen of the United States will be exempt from withholding or other Puerto Rico taxes.

Interest on exchange notes received by a non-Puerto Rico holder, other than a non-Puerto Rico holder that is a citizen of the United States, will also be exempt from withholding or other Puerto Rico taxes, except in the case of a non-Puerto Rico holder that may be regarded as a "related person" with respect to Telecomunicaciones de Puerto Rico. For this purpose, a "related person" generally will be a person that

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directly or indirectly owns 50% or more in value of the stock of Telecomunicaciones de Puerto Rico, or a corporation or partnership 50% or more of the value of whose stock or interests are owned directly or indirectly by Telecomunicaciones de Puerto Rico.

The Puerto Rico Code does not provide rules with respect to the treatment of the excess of the amount due at maturity over the initial offering price. Under current administrative practice followed by the Puerto Rico Department of Treasury, original issue discount (if any) on the exchange notes would be treated as interest.

#### SALE OR RETIREMENT OF NOTES

Any gain realized on the sale or other disposition of exchange notes by a non-Puerto Rico holder will not be subject to Puerto Rico taxes, except in the case where such gain constitutes income from sources within Puerto Rico. In general, gain realized on the sale or other disposition of an exchange note will constitute income from sources within Puerto Rico if the sale or other disposition of the exchange note occurs in Puerto Rico, i.e., if all right, title and interest in the exchange note passes from the seller to the purchaser in Puerto Rico. Retirement of the old notes in New York at the office of the paying agent, and sale of the exchange notes effected through transfer of beneficial ownership on the depository's records or the records of a U.S.-based participant thereof, pursuant to instructions given outside Puerto Rico, will not be considered to have occurred in Puerto Rico.

Any gain subject to tax in Puerto Rico on the sale or other disposition of an exchange note will be included in an annual Puerto Rico income tax return due from such non-Puerto Rico holder. Non-Puerto Rico holders should consult their tax advisors with respect to the Puerto Rico tax consequences to them in the case of a sale or other disposition of exchange notes that is considered to have occurred in Puerto Rico.

#### REGISTRATION OF NOTES

Any gain realized by non-Puerto Rico holders on an exchange of old notes for exchange notes pursuant to the exchange offer will not be subject to Puerto Rico income tax provided the exchange, as contemplated, is effected outside Puerto Rico.

An exchange of the old notes for exchange notes will be considered to have occurred outside Puerto Rico if the exchange of such notes occurs physically at the office of the exchange agent in New York, pursuant to instructions given by the holder and notice of acceptance given by the Telecomunicaciones de Puerto Rico, in each case outside of Puerto Rico.

THE UNITED STATES FEDERAL INCOME TAX DISCUSSION AND THE PUERTO RICO TAX DISCUSSION SET FORTH ABOVE ARE INCLUDED FOR GENERAL INFORMATION ONLY AND MAY NOT BE APPLICABLE DEPENDING UPON A HOLDER'S PARTICULAR SITUATION. HOLDERS SHOULD CONSULT THEIR TAX ADVISORS WITH RESPECT TO THE TAX CONSEQUENCES TO THEM OF THE OWNERSHIP AND DISPOSITION OF THE NOTES, INCLUDING THE TAX CONSEQUENCES UNDER

STATE, LOCAL, FOREIGN AND OTHER TAX LAWS AND THE POSSIBLE EFFECTS OF CHANGES IN UNITED STATES FEDERAL, PUERTO RICO OR OTHER TAX LAWS.

LEGAL MATTERS

The validity of the exchange notes, guarantees and certain other matters governed by U.S. federal and New York state law will be passed upon by Curtis, Mallet-Prevost, Colt & Mosle LLP, special U.S. and New York counsel to Telecomunicaciones de Puerto Rico, Puerto Rico Telephone Company and Celulares Telefonica, Inc. Certain matters governed by Puerto Rico law will be passed upon by O'Neill & Borges, special Puerto Rico counsel to Telecomunicaciones de Puerto Rico.

EXPERTS

The combined financial statements of Puerto Rico Telephone Company and Celulares Telefonica, Inc. and related notes thereto as of December 31, 1998 and 1997 and for each of the three years in the period ended December 31, 1998, the consolidated balance sheet of Telecomunicaciones de Puerto Rico, Inc. and

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subsidiaries as of June 30, 1999, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for the period from March 2, 1999 through June 30, 1999, and the combined statements of operations, comprehensive income (loss), changes in shareholder's equity and cash flows of Puerto Rico Telephone Company, Inc. and Celulares Telefonica, Inc. for the period from January 1, 1999 to March 1, 1999 incorporated in this prospectus, have been audited by Deloitte & Touche LLP, independent auditors, as stated in their reports appearing herein, and are included in reliance upon the reports of such firm given upon their authority as experts in accounting and auditing.

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(PREDECESSORS)

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors of  
Puerto Rico Telephone Company and Celulares Telefonica, Inc.:

We have audited the accompanying combined balance sheets of Puerto Rico Telephone Company and Celulares Telefonica, Inc. (the "Companies") as of December 31, 1998 and 1997, and the related combined statements of income, comprehensive income, changes in shareholder's equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Companies' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such combined financial statements present fairly, in all material respects, the combined financial position of Puerto Rico Telephone Company and Celulares Telefonica, Inc. as of December 31, 1998 and 1997, and the combined results of their operations and their cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

Deloitte & Touche LLP  
San Juan, Puerto Rico

February 25, 1999  
(March 2, 1999 as to Note 13)

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

COMBINED BALANCE SHEETS  
DECEMBER 31, 1998 AND 1997

<TABLE>  
<CAPTION>

	1998	1997
	-----	-----
	(IN THOUSANDS)	
<S>	<C>	<C>
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents.....	\$ 35,611	\$ 21,
Accounts receivable, net of allowance for doubtful accounts of \$56,003,000 and \$64,277,000 in 1998 and 1997, respectively.....	365,137	319,
Inventory and supplies.....	28,117	35,
Prepaid expenses.....	6,491	3,
	-----	-----
Total current assets.....	435,356	379,
PROPERTY, PLANT AND EQUIPMENT, Net (Notes 1, 2 and 6).....	1,987,901	2,019,
OTHER ASSETS, Net (Note 3).....	33,347	35,
	-----	-----
TOTAL.....	\$2,456,604	\$2,434,
	=====	=====
LIABILITIES AND SHAREHOLDER'S EQUITY		
CURRENT LIABILITIES:		
Current portion of obligations under capital leases (Note 6).....	\$ 235	\$
Accounts payable and accrued expenses.....	286,513	199,
Compensated absences and other liabilities.....	60,480	43,
	-----	-----
Total current liabilities.....	347,228	243,
OBLIGATIONS UNDER CAPITAL LEASES, LESS CURRENT PORTION (Note 6).....	515	
CUSTOMERS' DEPOSITS.....	41,437	42,
EMPLOYEE BENEFIT PLANS LIABILITY (Note 5).....	221,085	196,
OTHER LIABILITIES.....	33,655	26,
	-----	-----
Total liabilities.....	643,920	509,
	-----	-----
COMMITMENTS AND CONTINGENCIES (Notes 6 and 9)		
SHAREHOLDER'S EQUITY:		
Common stock.....	6	
Additional paid-in capital.....	1,835,800	1,930,
Retained earnings.....	--	
Accumulated other comprehensive loss (Note 5).....	(23,122)	(5,
	-----	-----
Total shareholder's equity.....	1,812,684	1,925,
	-----	-----
TOTAL.....	\$2,456,604	\$2,434,
	=====	=====

&lt;/TABLE&gt;

See notes to combined financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

COMBINED STATEMENTS OF INCOME  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>  
<CAPTION>

1998	1997
-----	-----
(IN THOUSANDS)	

<S>	<C>	<C>
REVENUES AND SALES:		
Local services.....	\$ 467,819	\$ 447,338
Long distance services (Note 4).....	251,754	252,259
Access services (Note 4).....	300,448	277,469
Cellular services.....	100,265	102,082
Paging services.....	59,728	55,212
Directory services.....	40,195	42,611
Other services and sales.....	50,475	57,150
	-----	-----
Total revenues and sales.....	1,270,684	1,234,121
	-----	-----
OPERATING COSTS AND EXPENSES:		
Cost of services and sales.....	482,877	450,288
Selling, general and administrative.....	264,013	260,084
Depreciation and amortization (Note 1).....	296,493	279,198
	-----	-----
Total operating costs and expenses.....	1,043,383	989,570
	-----	-----
OPERATING INCOME.....	227,301	244,551
	-----	-----
OTHER INCOME (EXPENSE):		
Interest income.....	3,208	3,705
Other expense, net (Note 7).....	(6,142)	(2,452)
	-----	-----
Total other (expense) income, net.....	(2,934)	1,253
	-----	-----
NET INCOME (Note 8).....	\$ 224,367	\$ 245,804
	=====	=====

&lt;/TABLE&gt;

See notes to combined financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

COMBINED STATEMENTS OF COMPREHENSIVE INCOME  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

&lt;TABLE&gt;

&lt;CAPTION&gt;

	1998	1997
	-----	-----
		(IN THOUSANDS)
<S>	<C>	<C>
NET INCOME.....	\$224,367	\$245,804
OTHER COMPREHENSIVE INCOME (LOSS):		
Minimum pension liability adjustment.....	(17,362)	6,259
	-----	-----
COMPREHENSIVE INCOME.....	\$207,005	\$252,063
	=====	=====

&lt;/TABLE&gt;

See notes to combined financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

COMBINED STATEMENTS OF CHANGES IN SHAREHOLDER'S EQUITY  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>  
<CAPTION>

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	ACCUMULATED OTHER COMPREHENSIVE LOSS
			(IN THOUSANDS)	
<S>	<C>	<C>	<C>	<C>
BALANCE, DECEMBER 31, 1995.....	\$ 5	\$1,824,605	\$ --	\$ (12,9
Net income.....			141,729	
Dividends and return of capital.....		(361,335)	(141,729)	
Capital contributions.....	1	400,084		
Minimum pension liability adjustment.....				8
BALANCE, DECEMBER 31, 1996.....	6	1,863,354	--	(12,0
Net income.....			245,804	
Dividends and return of capital.....		(255,458)	(245,804)	
Capital contributions.....		322,896		
Minimum pension liability adjustment.....				6,2
BALANCE, DECEMBER 31, 1997.....	6	1,930,792	--	(5,7
Net income.....			224,367	
Dividends and return of capital.....		(305,468)	(224,367)	
Capital contributions.....		210,476		
Minimum pension liability adjustment.....				(17,3
BALANCE, DECEMBER 31, 1998.....	\$ 6	\$1,835,800	\$ --	\$ (23,1

</TABLE>

See notes to combined financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

COMBINED STATEMENTS OF CASH FLOWS  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>  
<CAPTION>

	1998	1997
	(IN THOUSANDS)	
<S>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income.....	\$ 224,367	\$ 245,804
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	296,493	279,198
Loss on retirement of telephone plant.....	13,638	--
Changes in assets and liabilities:		
Accounts receivable.....	(45,670)	(14,860)
Inventory and supplies.....	7,709	23,606
Prepaid expenses.....	(3,307)	(153)
Other assets.....	(346)	5,351
Accounts payable and accrued expenses, employee benefit plans, compensated absences and other		

liabilities, customers' deposits and other liabilities.....	120,867	(30,706)
Net cash provided by operating activities.....	613,751	508,240
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Acquisition and construction of telephone plant, including cost of removal.....	(287,988)	(362,247)
Net salvage on retirements.....	8,382	10,923
Net cash used in investing activities.....	(279,606)	(351,324)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Dividends and return of capital.....	(529,835)	(501,262)
Capital contributions.....	210,476	322,896
Principal payments on capital lease obligations.....	(429)	(325)
Net cash used in financing activities.....	(319,788)	(178,691)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS....	14,357	(21,775)
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR.....	21,254	43,029
CASH AND CASH EQUIVALENTS AT END OF YEAR.....	\$ 35,611	\$ 21,254

&lt;/TABLE&gt;

See notes to combined financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

## 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

## ORGANIZATION

Puerto Rico Telephone Company ("PRTC"), a Delaware corporation and a wholly-owned subsidiary of Puerto Rico Telephone Authority (the "Authority") has served as the primary provider of wireline local and inter-island long distance telephone service in Puerto Rico. It was granted by the government the exclusive franchises to provide these services and in exchange had the rates it charged to customers established based upon its costs of providing non-discriminatory services including a return on invested capital. The return on capital was remitted to the Authority in the form of dividends each year. In addition, PRTC participated in the cost-sharing pools established by the National Exchange Carriers Association ("NECA") and in the universal service funds that provide recovery of cost of service in rural high cost areas. Since 1996, regulation of the rates and operations of PRTC were transferred to the Puerto Rico Telecommunications Regulatory Board ("the Telecommunications Board"), an independent agency of the Commonwealth of Puerto Rico established by the Puerto Rico Telecommunications Act of 1996 to assume responsibility for regulating telephone carriers. The Telecommunications Act directs the Telecommunications Board to presume that PRTC controls the local service access and on-island toll markets as of the date of enactment. The Telecommunications Act requires a list of rates and charges be submitted to it and that they are to be based upon the cost of providing services to customers. Accordingly, PRTC has followed the accounting principles provided in Statement of Financial Accounting Standards (SFAS) No. 71, ACCOUNTING FOR THE EFFECTS OF CERTAIN TYPES OF REGULATION.

In October 1997, the Federal Communications Commission ("FCC") issued an order requiring that incumbent local exchange carriers establish a separate affiliate for the provision of in-region broadband Commercial Mobile Radio Services. Effective September 1, 1998, Celulares Telefonica, Inc. ("CT") (a Predecessor of the Company), which previously operated as a division of PRTC, was organized as a separate corporation to provide the services as instructed by the FCC.

#### PRINCIPLES OF COMBINATION

The accompanying combined financial statements include the accounts of PRTC and CT (the "Companies") as of December 31, 1998 and 1997 and for each of the three years in the period ended December 31, 1998. All significant intercompany balances and transactions have been eliminated in combination.

#### USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is stated at the original cost of acquisition or construction. Maintenance, repairs and the cost of removal of minor items of property are charged to expense. Replacements of major items of property are charged to the plant accounts. Property retired or otherwise disposed of in the ordinary course of business, together with the cost of removal, less salvage, is charged to accumulated depreciation with no gain or loss recognized. Depreciation and amortization is computed on the straight-line method at rates considered adequate to allocate the cost of the various classes of property over their estimated service lives.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

#### CASH AND CASH EQUIVALENTS

All short-term investments with original maturities of three months or less are considered to be cash equivalents.

#### ALLOWANCE FOR DOUBTFUL ACCOUNTS

The allowance for doubtful accounts is an amount that management believes will be adequate to absorb possible losses on existing receivables that may become uncollectible based on evaluations of the collectibility of the receivables and prior loss experience. Because of uncertainties inherent in the estimation process, management's estimate of losses in the receivables outstanding and the related allowance may change in the near term.

#### INVENTORY AND SUPPLIES

Inventory and supplies are stated at average cost.

#### IMPAIRMENT OF LONG-LIVED ASSETS

The Companies periodically review long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As the Government of Puerto Rico moves forward with the privatization of the Companies, if the rate setting process is deregulated so that rates are no longer based upon the Companies' cost of providing service and if the Companies' markets are opened to entry by competitors, the Companies may need to reassess their ability to continue to follow regulatory accounting principles and the ability to realize its investment in property, plant and equipment.

#### LONG DISTANCE, ACCESS, AND OTHER REVENUES

Revenues are generally recognized when services are rendered or products are delivered to customers.

Long distance and access services revenues are derived from long distance calls within Puerto Rico, carrier charges for access to the local exchange network, subscriber line charges and other services offered to the long distance carriers under contractual arrangements. Carrier Common Line access services revenues are generated based on the participation by the Companies in revenue pools with other telephone companies managed by NECA, which are funded by access charges authorized by the FCC and long term support amounts received from the Universal Service Fund. Such pooled amounts are subsequently divided among the various telephone companies based upon their respective estimated allocations of costs and investments in providing interstate services.

Revenues generated from access services and certain other long distance services have been determined from preliminary allocations and cost studies and are subject to final settlements in subsequent periods (refer to Note 4).

Toll services provided from overseas long distance telecommunications services are recognized when earned regardless of the period in which they are billed to the customer.

Other revenues include services generated based on independent agreements with long distance carriers.

Installation fees, which are set at amounts intended to recover the cost of installation, are recognized as revenue at the time of installation. Installation revenues in excess of installation costs, if any, are deferred and amortized over the estimated life of the customer.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

#### EMPLOYEE BENEFIT PLANS

Pension and postretirement health care and life insurance benefits earned as well as interest on projected benefit obligations are accrued currently. Prior service costs and credits resulting from changes in plan benefits are amortized over the average remaining service period of the employees expected to receive the benefits.

#### FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts reported in the combined balance sheets for cash and

cash equivalents, accounts receivable and accounts payable approximate fair value due to their short-term duration.

#### RECLASSIFICATIONS

Reclassifications of prior year data have been made, where appropriate, to conform to the 1999 presentation.

#### IMPACT OF RECENT ACCOUNTING PRONOUNCEMENTS

In 1998, the Companies adopted Statement of Financial Accounting Standards ("SFAS") No. 130, REPORTING COMPREHENSIVE INCOME. This Statement establishes standards for reporting and displaying comprehensive income and its components (revenues, expenses, gains and losses) in a full set of general-purpose financial statements. Comprehensive income is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. It includes all changes in equity during a period except those resulting from investments by owners and distributions to owners.

In 1998, the Companies adopted SFAS No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION. This statement introduces a new model for segment reporting, called the "management approach." The management approach is based on the way that the chief operating decision maker organizes segments within a company for making operating decisions and assessing performance. Reportable segments are based on products and services, geography, legal structure, management structure -- any manner in which management disaggregates a company. The management approach replaces the notion of industry and geographic segments in current Financial Accounting Standards Board ("FASB") standards. Management operates and reports the results of operations in two segments -- Wireline and Wireless telecommunications, which conforms to its two operating segments.

In June 1998, the FASB issued SFAS No. 133, ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES, which established accounting and reporting standards for derivative instruments and hedging instruments. SFAS No. 133, as amended, is effective January 1, 2001. The statement requires entities that use derivative instruments to measure and record these instruments at fair value as assets or liabilities on the balance sheet. It also requires entities to reflect the gains or losses associated with changes in the fair value of these derivatives, either in earnings or as a separate component of comprehensive income, depending on the nature of the underlying contract or transaction. The Companies do not currently utilize derivative instruments. Therefore, the adoption of SFAS No. 133 is not expected to have a significant effect on the Companies' results of operations or its financial condition.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

#### NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED) YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

#### 2. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at December 31, 1998 and 1997 consists of:

<TABLE>  
<CAPTION>

	1998	1997
	-----	-----
	(IN THOUSANDS)	
<S>	<C>	<C>



Land.....	\$ 26,871	\$ 26,
Buildings.....	315,867	304,
Central office and transmission equipment.....	1,004,347	915,
Outside plant.....	1,733,846	1,672,
Other equipment.....	359,282	348,
	-----	-----
Total plant in service.....	3,440,213	3,267,
Less accumulated depreciation and amortization.....	1,701,288	1,477,
	-----	-----
Net plant in service.....	1,738,925	1,789,
Construction in progress.....	248,976	229,
	-----	-----
Total.....	\$1,987,901	\$2,019,
	=====	=====

&lt;/TABLE&gt;

## 3. OTHER ASSETS

Other assets at December 31, 1998 and 1997, consist of:

&lt;TABLE&gt;

&lt;CAPTION&gt;

	1998	1997
	-----	-----
	(IN THOUSANDS)	
<S>	<C>	<C>
Deferred pension asset (note 5).....	\$21,664	\$25,312
Other.....	11,683	10,615
	-----	-----
Total.....	\$33,347	\$35,927
	=====	=====

&lt;/TABLE&gt;

## 4. LONG DISTANCE, ACCESS, AND OTHER REVENUES

The Companies long distance, access, and other revenues increased by \$491,000, \$8,994,000 and \$2,228,000 in 1998, 1997 and 1996, respectively, to reflect settlements of prior years revenues.

## 5. PENSION PLANS

The Companies have two separate noncontributory defined benefit pension plans covering substantially all of their salaried and hourly employees. The Companies' funding policy for these plans is to make annual contributions as required by applicable regulations. Contributions are intended to provide not only for benefits attributed to service to date, but also for those expected to be earned in the future. Plan assets are invested in equity and government securities and in other instruments.

All salaried and hourly employees of the Companies participate in the Puerto Rico Telephone Company Lump Sum Retirement Plan (the "Lump Sum Plan"). Participants are entitled to a lump sum amount equal to a specified number of months of the employee's earnings. The specified number of months is determined based on the employees' years of service. The Lump Sum Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, and is qualified under the Puerto Rico Internal Revenue Code; accordingly, the Lump Sum Plan is exempt from income tax in Puerto Rico.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)

## YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

The Companies provide certain health care and life insurance benefits for retired employees. Substantially all of the employees may become eligible for those benefits if they reach normal retirement age while working for the Companies.

The following table sets forth the status of the plans, the actuarial assumptions and the amounts in the Companies' combined balance sheets as of December 31, 1998 and 1997:

&lt;TABLE&gt;

&lt;CAPTION&gt;

	PENSION AND LUMP SUM BENEFITS		OTHER POSTRETIREMENT BENE	
	1998	1997	1998	1997
	(IN THOUSANDS)			
<S>	<C>	<C>	<C>	<C>
Change in benefit obligation:				
Benefit obligation at beginning of year.....	\$ 617,694	\$ 575,266	\$ 132,340	\$ 146,340
Service cost.....	17,795	16,517	3,981	3,981
Interest cost.....	48,640	45,677	11,404	9,981
Amendments.....	--	13,969	--	--
Actuarial loss (gain).....	114,131	804	37,276	(21,276)
Benefits paid.....	(37,074)	(34,539)	(7,555)	(6,555)
Benefit obligation at end of year.....	761,186	617,694	177,446	132,340
Change in plan assets:				
Fair value of plan assets at beginning of year.....	426,528	346,223	--	--
Actual return on plan assets.....	74,559	57,065	--	--
Employer contributions.....	41,668	57,779	--	--
Benefits paid.....	(37,074)	(34,539)	--	--
Fair value of plan assets at end of year.....	505,681	426,528	--	--
Funded status.....	(255,505)	(191,166)	(177,446)	(132,340)
Unrecognized (gain) loss.....	107,742	34,033	26,657	(10,657)
Unrecognized prior service cost.....	33,519	38,634	16,649	18,649
Unrecognized net transition obligation.....	9,407	10,689	62,678	67,678
Net amount recognized.....	\$ (104,837)	\$ (107,810)	\$ (71,462)	\$ (57,462)
Amounts recognized in the combined balance sheets consist of:				
Accrued benefit liability.....	\$ (149,623)	\$ (138,882)	\$ (71,462)	\$ (57,462)
Intangible asset (Note 3).....	21,664	25,312	--	--
Accumulated other comprehensive loss.....	23,122	5,760	--	--
Net amount recognized.....	\$ (104,837)	\$ (107,810)	\$ (71,462)	\$ (57,462)

&lt;/TABLE&gt;

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.

## (PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
 YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

<TABLE>  
 <CAPTION>

	PENSION AND LUMP SUM BENEFITS			OTHER POSTRETIREMENT	
	1998	1997	1996	1998	1997
<S>	<C>	<C>	<C>	<C>	<C>
Weighted-average assumptions as of December 31 of each year:					
Discount rate.....	7%	8%	8%	7%	8%
Rate of compensation increase.....	6%	6%	6%	6%	6%
Expected return on plan assets.....	9%	8%	8%	n/a	n/a

</TABLE>

The assumed health-care cost trend rate used in 1998, 1997 and 1996 in measuring the accumulated postretirement benefit obligation was 7%, 8%, and 9%, respectively, declining by 1% per year to an ultimate rate of 5%.

In accordance with the provisions of SFAS No. 87, EMPLOYERS' ACCOUNTING FOR PENSIONS, the Companies were required to record an additional minimum pension liability at December 31, 1998 and 1997. This amount represents the excess of the accumulated benefit obligations over the fair value of plan assets and accrued pension liabilities. The liabilities have been offset by intangible assets to the extent possible. Because the asset recognized may not exceed the amount of unrecognized prior service cost, the balance of the liability at the end of each period is reported as a separate reduction to shareholder's equity (Accumulated Other Comprehensive Loss).

See Note 13 for a description of the Authority's commitment to contribute \$200 million over five years to cover unfunded pension and other post-employment benefit obligations.

The net periodic pension cost for the years ended December 31, 1998, 1997 and 1996 include the following components:

<TABLE>  
 <CAPTION>

	PENSION AND LUMP SUM BENEFITS			OTHER POSTRETIREMENT BENEFIT		
	1998	1997	1996	1998	1997	1
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Service cost.....	\$ 17,795	\$ 16,517	\$ 14,070	\$ 3,981	\$ 3,510	\$
Interest cost.....	48,640	45,677	41,586	11,404	9,748	1
Expected return on plan assets.....	(34,280)	(58,138)	(36,516)	--	--	--
Net amortization and deferral.....	6,539	36,187	19,264	6,655	5,906	--
Effect of early retirement program.....	--	--	99,102	--	--	--
Net periodic pension cost.....	\$ 38,694	\$ 40,243	\$137,506	\$22,040	\$19,164	\$2

</TABLE>

On January 25, 1996, a program was approved which allowed for the early retirement of salaried employees who as of December 31, 1995 met certain specific requirements. This "window benefit" program was accepted by most of the eligible employees. The early retirement program resulted in an increase of approximately \$99 million in the net periodic pension cost for the year ended December 31, 1996.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

PUERTO RICO EMPLOYEES' RETIREMENT SYSTEM

Some of the Companies' employees (the former employees of Puerto Rico Communications Corporation, which was merged with PRTC on May 4, 1994) participate in the Commonwealth of Puerto Rico Employees' Retirement System (the "System"), a cost-sharing multiple-employer retirement system.

The Companies are required to contribute 9.275% of the employees' salaries. Total payroll covered for the year ended December 31, 1998 was approximately \$16,752,000. Total employee and employer contributions for the year ended December 31, 1998 amounted to approximately \$1,285,000 and \$1,538,000, respectively. See Note 13 for change resulting from the acquisitions of PRTC and CT by the GTE Group.

6. LEASES

The Companies use certain building facilities and equipment under various capital and operating lease agreements.

At December 31, 1998 and 1997, the cost and accumulated amortization of building facilities and equipment under capital leases are as follows:

<TABLE>  
<CAPTION>

	1998	1997
	-----	-----
	(IN THOUSANDS)	
<S>	<C>	<C>
Cost.....	\$1,675	\$2,305
Less accumulated amortization.....	1,111	1,521
	-----	-----
Total.....	\$ 564	\$ 784
	=====	=====

</TABLE>

The amortization of the building facilities and equipment under capital leases is included in the depreciation and amortization expense account.

Future minimum lease payments under non-cancelable capital and operating leases in effect at December 31, 1998 are as follows:

<TABLE>  
<CAPTION>

	CAPITAL	OPERATING
	-----	-----
	(IN THOUSANDS)	
<S>	<C>	<C>
YEAR ENDING DECEMBER 31,		
1999.....	\$295	\$ 7,418

2000.....	209	5,083
2001.....	90	3,063
2002.....	90	1,744
2003.....	90	1,340
Thereafter.....	195	9,215
	----	-----
Total minimum lease payments.....	969	27,863
Less amount representing interest.....	219	--
	----	-----
Present value of minimum lease payments.....	\$750	\$27,863
	=====	=====

&lt;/TABLE&gt;

Rental costs charged to operations under operating leases for the years ended December 31, 1998, 1997 and 1996 amounted to approximately \$9,898,000, \$10,426,000 and \$9,361,000, respectively.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

## 7. OTHER EXPENSE, NET

The components of other expense at December 31, 1998, 1997 and 1996 are as follows:

&lt;TABLE&gt;

&lt;CAPTION&gt;

	1998	1997	1996
	-----	-----	-----
	(IN THOUSANDS)		
	<C>	<C>	<C>
Interest expense.....	\$ 729	\$ 710	\$1,7
Other expenses.....	5,413	1,742	7
	-----	-----	-----
Total.....	\$6,142	\$2,452	\$2,4
	=====	=====	=====

&lt;/TABLE&gt;

## 8. TAXES

As discussed in Note 13, the Companies were wholly-owned subsidiaries of Puerto Rico Telephone Authority until March 2, 1999. The act authorizing the creation of the Authority exempts the Authority and its wholly-owned subsidiaries from all taxes levied on their properties or revenues by the Commonwealth of Puerto Rico and its municipalities. Therefore, the Companies were exempt from income, property and other taxes in Puerto Rico. For the periods covered in the accompanying combined financial statements of the Companies, all taxes and payments in lieu of taxes were the responsibility of the Authority.

## 9. COMMITMENTS AND CONTINGENCIES

## (a) CONSTRUCTION COMMITMENTS

The Companies' construction program for 1999 amounts to approximately \$224 million, including commitments for the purchase and installation of telephone equipment and materials and supplies.

## (b) LITIGATION

The Companies and their former parent company, Puerto Rico Telephone Authority, have been advised of certain unasserted claims and were defendants in several lawsuits including those arising out of the conduct of their normal course of business, including those related to regulatory actions and commercial transactions. These claims have been vigorously contested and management of the Authority and the Companies, after consultation with legal counsel, established adequate reserves to cover the claims. Management believes that the final resolution of the legal cases will not have a material adverse effect on their financial statements.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED)  
YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

## 10. SHAREHOLDER'S EQUITY

Capital stock at December 31, 1998 and 1997 consists of:

<TABLE>  
<CAPTION>

	COMMON STOCK	ADDITIONAL PAID-IN CAPITAL
	-----	-----
DECEMBER 31, 1998		
<S>	<C>	<C>
Puerto Rico Telephone Company:		
Common stock -- par value of \$10 per share:		
1,000 shares authorized; 589 shares issued and outstanding.....	\$6	\$1,670,988
Celulares Telefonica, Inc.:		
Common stock -- no par value: 10,000 shares authorized; unissued.....	--	164,812
Total.....	\$6 ==	\$1,835,800 =====
DECEMBER 31, 1997		
Puerto Rico Telephone Company:		
Common stock -- par value of \$10 per share;		
1,000 shares authorized; 579 shares issued and outstanding.....	\$6 --	\$1,930,792 -----

&lt;/TABLE&gt;

Under the terms of the Trust Agreement of the Authority with a financial institution, the Companies were required to pay monthly dividends to the Authority in amounts equal to their revenues less current expenses, excluding depreciation and the Authority's current debt service requirements. Such dividends were charged against retained earnings to the extent available and any excess was accounted for as a return of capital to the Authority.

## 11. SIGNIFICANT EVENT

On September 21, 1998, Puerto Rico was struck by a hurricane which caused extensive damages to the Island. The effect of the damages on the Companies' telephone plant and telecommunications services was represented by the book value of telephone plant destroyed and retired from the books of approximately \$13.6 million, cost of repairs and reconstruction of telephone plant of approximately \$54.0 million, and loss of revenues of approximately \$18.6

million. At December 31, 1998, the Companies recorded expenses amounting to approximately \$31.7 million related to the above losses and as other income amounts received from insurance companies and insurance claims outstanding for approximately \$6.4 million. In addition, the construction program for the year was reallocated during the last quarter of 1998 to address reconstruction of the telephone plant and services.

## 12. CASH FLOW INFORMATION

Noncash operating activities included changes in the accrual of additional minimum liability amounting to approximately \$13,714,000, \$4,061,000 and \$3,495,000 as of December 31, 1998, 1997 and 1996, respectively, which had an effect on deferred pension asset, employee benefit plans liability and accumulated other comprehensive loss.

## 13. SALE OF THE COMPANIES

On April 7, 1997, the Governor of Puerto Rico announced the intention of the Commonwealth of Puerto Rico to sell the Companies. In August 1997, the Governor signed the legislation approved by the Legislature

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

### NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED) YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

of Puerto Rico authorizing a committee to be designated by the Governor to initiate the process to identify prospective buyers. In May 1998, the Governor announced that the process had been completed, and that the Companies would be sold to a consortium led by GTE Corporation. On February 12, 1999, the FCC approved the sale of the Companies to a subsidiary of GTE Corporation. The closing of the sale occurred on March 2, 1999 under the following terms:

- An Employee Stock Option Plan ("ESOP") was created, wherein the Government of Puerto Rico contributed three percent (3%), and a subsidiary of GTE Corporation and Popular Inc. contributed one percent (1%) of the stock to the ESOP. The ESOP acquired an additional three percent (3%) with funds borrowed from Telecomunicaciones de Puerto Rico, Inc. ("Telpri").
- A subsidiary of GTE Corporation acquired 40.01% plus one share of Telpri stock and Popular Inc. acquired 9.99% at the date of the closing.
- The Government of Puerto Rico retained forty-three percent (43%) less one share of the shares of the stock of Telpri.
- The Authority received approximately \$2.040 billion from the transaction. Also, the Authority agreed to contribute cash or stock worth \$200 million over the next five years to cover unfunded pension and other post-employment benefit obligations. Upon receipt of this contribution, the Companies will be required to contribute amounts to the plans which will produce an estimated tax benefit of approximately \$128 million.

In addition, effective on the date of the closing the Companies' employees which participated in the Commonwealth of Puerto Rico Employees' Retirement System discontinued participating in the plan and became participants of the Companies' noncontributory defined benefit pension plans.

Effective January 1, 1999, Puerto Rico Telephone Company, which was an entity incorporated under the laws of the state of Delaware, U.S.A., was reorganized as a Puerto Rico corporation under the name Puerto Rico Telephone

Company, Inc. On March 1, 1999, the ownership of Puerto Rico Telephone Company, Inc. and Celulares Telefonica, Inc. was transferred to Telecomunicaciones de Puerto Rico, Inc., which acquired all of PRTC and CT's stock from Puerto Rico Telephone Authority.

#### 14. SEGMENT INFORMATION

Effective December 31, 1998, the Companies adopted SFAS No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION. SFAS No. 131 establishes standards for reporting financial information about operating segments in complete sets of financial statements.

The Companies have two reportable segments, Wireline and Wireless, in which the Companies operate and organize their services. The Wireline segment provides:

- Local service including basic voice, telephone and PBX rental, public phone services, value-added services, high speed private line services, Internet access and installations.
- Long distance service both in and off the island. Off-island services began on February 1, 1999.
- Access service provided to long distance, competitor local exchange carriers, cellular and paging operators to originate and terminate calls on its network.
- Directory publishing right revenues and listing fees.
- PBX equipment sales and billing and collection services to competitor long distance operators in Puerto Rico.

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PUERTO RICO TELEPHONE COMPANY AND CELULARES TELEFONICA, INC.  
(PREDECESSORS)

#### NOTES TO COMBINED FINANCIAL STATEMENTS -- (CONTINUED) YEARS ENDED DECEMBER 31, 1998, 1997 AND 1996

The Wireless segment includes cellular and paging services and related equipment sales.

The Companies measure and evaluate the performance of their segments based on operating income. The accounting policies of the segments are the same as those described in Note 1. The Companies account for intersegment sales of products and services at current market prices. Intersegment revenues were not material in 1998, 1997 and 1996. The Companies are not dependent on any single customer.

Segment results for the years ended December 31 were as follows:

<TABLE>  
<CAPTION>

	1998	1997	1996
	-----	-----	-----
	(IN THOUSANDS)		
<S>	<C>	<C>	<C>
WIRELINE			
Revenues and sales:			
Local services.....	\$ 467,819	\$ 447,338	\$ 419
Long distance services.....	251,754	252,259	263
Access services.....	300,448	277,469	257
Directory services and other.....	90,670	99,761	92



Total.....	\$1,110,691	\$1,076,827	\$1,032
Operating income.....	\$ 203,137	\$ 224,896	\$ 103
Depreciation and amortization.....	275,005	261,711	240
Capital expenditures.....	250,986	324,231	351
Total assets.....	2,231,822	2,263,672	2,234
WIRELESS			
Revenues and sales:			
Cellular services.....	\$ 100,265	\$ 102,082	\$ 135
Paging services.....	59,728	55,212	33
Total.....	\$ 159,993	\$ 157,294	\$ 168
Operating income.....	\$ 24,164	\$ 19,655	\$ 37
Depreciation and amortization.....	21,488	17,487	13
Capital expenditures.....	31,675	30,471	32
Total assets.....	224,782	171,134	153
CONSOLIDATED REVENUES AND SALES.....	\$1,270,684	\$1,234,121	\$1,201
CONSOLIDATED OPERATING INCOME.....	\$ 227,301	\$ 244,551	\$ 140
CONSOLIDATED ASSETS.....	\$2,456,604	\$2,434,806	\$2,388

&lt;/TABLE&gt;

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## INDEPENDENT AUDITORS' REPORT

The Board of Directors of  
Telecomunicaciones de Puerto Rico, Inc:

We have audited the accompanying consolidated balance sheet of Telecomunicaciones de Puerto Rico, Inc. and subsidiaries (the "Company") as of June 30, 1999, and the related consolidated statements of operations, comprehensive income (loss), changes in shareholders' equity, and cash flows for the period from March 2, 1999 to June 30, 1999 and the combined balance sheet of Puerto Rico Telephone Company, Inc. and Celulares Telefonica, Inc. (the "Predecessors") as of December 31, 1998 and their combined statements of operations, comprehensive income (loss), changes in shareholder's equity and cash flows for the period from January 1, 1999 to March 1, 1999. These financial statements are the responsibility of the management of the Company and the Predecessors. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the consolidated financial position of Telecomunicaciones de Puerto Rico, Inc. and subsidiaries as of June 30, 1999 and the consolidated results of their operations and their cash flows for the period from March 2, 1999 to June 30, 1999, and the combined financial position of Puerto Rico Telephone Company, Inc. and Celulares Telefonica, Inc. as of December 31, 1998 and their combined results of operations and cash flows for the period from January 1, 1999 to March 1, 1999 in conformity with generally accepted accounting principles.